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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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IN THE MATTER OF THE APPLICATION OF
ARIZONA WATER COMPANY, AN ARIZONA
CORPORATION, FOR AUTHORITY TO
IMPLEMENT STEP-1 SURCHARGE OF AN
ARSENIC COST RECOVERY MECHANISM
FOR IN ITS SAN MANUEL SYSTEM

Docket No. W-01445A-11-0310

**NOTICE OF FILING RUCO'S REPORT ON
STEP ONE ARSENIC FILING – SAN MANUEL SYSTEM**

The Residential Utility Consumer Office ("RUCO") hereby provides its Audit Report of
Arizona Water Company's March 19, 2014 filing for an Arsenic Cost Recovery Mechanism
("ACRM") Step 1 rate increase for its Eastern Group San Manuel System.

RESPECTFULLY SUBMITTED this 13th day of May 2014.

Daniel Pozefsky
Chief Counsel

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2 of the foregoing filed this 13th day
3 of May, 2014 with:

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12 By Cheryl F. Faulob
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TO: Patrick Quinn, Director
Dan Pozefsky, Chief Counsel
Robert Mease, Chief of Accounting and Rates

FROM: Timothy J. Coley

DATE: May 13, 2014

RE: Report on RUCO's audit of Arizona Water Company's ("AWC") March 19, 2014 filing for an Arsenic Cost Recovery Mechanism ("ACRM") Step-One rate increase for AWC's San Manuel System.

AUDIT OBJECTIVE: The purpose and objective of this audit was to verify the capital expenditures for Arizona Water Company ("AWC" or "Company") San Manuel System's arsenic removal facility, which was recently completed and placed in service in November 2013. The scope of RUCO's audit was to verify that the facility is actually in service and to verify compliance with Decision Nos. 73736 (February 20, 2013) and 66400 (October 14, 2003, which authorized the ACRM), and to verify the accuracy of the Company's requested ACRM Step-One surcharge. The Company is seeking recovery of \$401,432 in capital expenditures related to the AWC's San Manuel System, which provides service to approximately 1,436 customers in San Manuel in southern Arizona.

AUDIT PROCEDURES: The following audit procedures were performed:

- 1) Verified that all schedules that are required by Decision No. 66400 are included in the application;
- 2) Reviewed Earnings Test for compliance, accuracy, and determined if the Company had passed the Earnings Test;
- 3) Reviewed all arsenic plant invoices and examined the data for misallocations, unreasonable costs, non-arsenic related plant costs, double billings, and to ascertain the expenditures qualify as capital expenditure costs as prescribed in Decision No. 66400 dated October 14, 2003;

- 4) Verified accuracy of Task Order totals and grand total;
- 5) Reviewed Revenue Requirement calculations for accuracy and compliance;
- 6) Reviewed rate design for compliance with 50/50 requirement, accuracy of calculations, and checked the reasonableness of the billing determinants by comparing to the prior rate case; and
- 7) Issued a RUCO data request and reviewed Commission Staff data requests for further clarification of certain requested items and discovery to satisfy RUCO's verification responsibilities on behalf of our residential ratepayers who reside in the service area of the San Manuel System.

AUDIT FINDINGS:

The Company purchases 100% of the water it provides to its San Manuel customers from BHP Copper, Inc. ("BHP"). The untreated water the Company purchases from BHP exceeds the EPA's MCL for arsenic. In 2007, the Company constructed an arsenic removal facility to reduce the level of arsenic in water it purchases from BHP in order to comply with the MCL. In 2010, BHP drilled two new wells to deliver water to the Company for its San Manuel system. The water quality of the new wells is such that the existing arsenic removal facility will not produce treated water that complies with the MCL for arsenic without additional modifications. The Company determined that with certain modifications, including pre-treatment pH adjustment, the existing facility could be modified to treat the new supply to comply with the MCL, thereby avoiding the significant cost of constructing a new arsenic removal facility. The Company commenced construction of the modifications in 2012 and placed the modifications in service in November 2013. A copy of the Arizona Department of Environmental Quality Approval of Construction was included in the Company's Application as an attachment. With de minimis findings, RUCO finds the Company's Application supports an ACRM fixed monthly surcharge of \$1.45 and an ACRM volumetric surcharge of \$0.2346 per 1,000 gallons. The Company estimates that the average monthly bill for customers in the San Manuel system (based on 6,844 gallons used and a 5/8-inch meter) will increase by \$3.05, or 6.03%, from \$50.62 to \$53.67.

RUCO RECOMMENDATIONS: The Company's ACRM request should be adopted by the Arizona Corporation Commission.